IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

TAX APPEAL No. 193 of 2003
With
TAX APPEAL No. 194 of 2003
With
TAX APPEAL No. 8 of 2004

For Approval and Signature:

HONOURABLE MR.JUSTICE D.A.MEHTA Sd/-

HONOURABLE MS.JUSTICE H.N.DEVANI Sd/-

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1 Whether Reporters of Local Papers may be allowed to see the judgment ?

2 To be referred to the Reporter or not ?

3 Whether their Lordships wish to see the fair copy of the judgment ?

4 Whether this case involves a substantial question of law as to the interpretation of the constitution of India, 1950 or any order made thereunder ?

5 Whether it is to be circulated to the civil judge ?

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M/S MUGAT DYEING & PRINTING MILLS - Appellant(s)

Versus

A.C.I.T. - Opponent(s)

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Appearance :
MR.S.N.DIVETIA for Appellant

MRS SWATI SOPARKAR for Appellant(s) : 1,
MR B.B.NAIK for Respondents.

NOTICE SERVED for Opponent(s) : 1,
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CORAM : HONOURABLE MR.JUSTICE D.A.MEHTA
and
HONOURABLE MS.JUSTICE H.N.DEVANI

Date : 02/02/2006

ORAL JUDGMENT

(Per : HONOURABLE MS.JUSTICE H.N.DEVANI)

In all these appeals, (though the frame of the questions in Tax Appeal No.8 of 2004 differs from that of the other appeals) the facts and issues involved are common. Hence, the same are taken up for hearing together, and disposed of by this common judgment. In all the appeals, learned Advocate Mr.S.N.Divetia addressed the Court on behalf of the appellants, Mr.B.B.Naik, learned Standing Counsel appeared on behalf of the respondent.

Tax Appeals No.193 & 194 of 2003.

1 Both these Appeals arise out of consolidated order dated 3/8/2002 passed by the Income-tax Appellate Tribunal, Ahmedabad, Bench-'C' for Assessment Years 1986-87 and 1987-88 respectively. The common dispute involved for both the Assessment Years relates to the disallowance of excise duty liabilities to the tune of Rs.58,75,999/- for the Assessment Year 1986-87 and Rs.44,58,378/- for Assessment Year 1987-88 by invocation of the provisions of Section 43B of the Income Tax Act,1961 (the Act).

2 Both these appeals were admitted by an order dated 14/7/2003 and the following substantial question of law was framed :

> *"Whether, on the facts and in the circumstances, of the case, the Tribunal was right in law in holding that the bank guarantee furnished by the assessee, which was taken by the assessee by depositing certain amount*

in bank fixed deposit as margin, did not tantamount to actual payment and so section 43B is applicable?"

3 The assessee firm is a processing house carrying on the business of dyeing and printing of cloth, entirely on job work basis. The grey cloth is supplied by the merchants i.e. owners of the cloth and after dyeing and printing, the same is returned to the respective merchants for which labour charges are recovered. The assessee also collected excise duty from the merchants on the cloth processed for them by way of separate debit note and the same was credited to the excise account of the merchants in a separate ledger account maintained for the purpose, and as and when the payment is made to the excise department this account is debited by such amount. There is no dispute that the aforesaid excise duty received, though kept in a separate account, is a trading receipt as held by this Court in the case of *Plastic Products*

Engg.Co. Vs. CIT 245 ITR 349 (Guj.). The excise duty is being charged by the Central Excise Department on the selling price of the cloth printed by the assessee for the merchants.

4. In so far as levy of excise duty which pertained to the value of job work done by the assessee, the same was not in dispute. However, as regards the portion of excise duty attributable to the value of grey cloth belonging to the merchant owners and processed by the assessee, the assessee disputed the levy before the excise authorities on the ground that as a processor of grey cloth on job work basis, the assessee was merely an agent of the merchant owner and therefore, no liability on account of excise duty could be levied under the Central Excise Duty and Salt Act,1944 and rules made thereunder. However, since the excise authorities did not accept the said contention, the assessee along with other processors of grey cloth

continued to collect the excise duty from the merchants on the full value of the cloth and job charges. The assessee along with other processors of grey cloth approached the Hon'ble Supreme Court by way of a writ petition, wherein the Supreme Court passed an interim order on 3/2/1984 in the following terms :

> *"Pending notice, the respondents, their servants and agents are restrained from levying and recovering the disputed portion of duty of excise i.e. duty on the difference between the ultimate price charges from the customer and the value of the processing work done by the petitioners on the condition that the petitioners shall furnish bank guarantee to the full extent in regard to the aforesaid difference to the satisfaction of the respondents. The Bank guarantee shall be furnished by the petitioners within four weeks of each of the clearance or demands as the case may be".*

5 In compliance with the stay order of the Supreme Court, the assessee firm deposited the equivalent amount of the disputed excise duty (attributable to the value of grey cloth) with

the bank in fixed deposit and furnished the bank guarantee to the excise authorities.

6 The Supreme Court ultimately decided the matter in favour of the Excise Department and the department realised the excise duty directly from the bank authorities by encashing the fixed deposits.

7 It is in the back drop of the aforesaid facts, that the issue involved in the present case is required to be considered.

8 In relation to both the assessment years the original assessments were completed on 2/2/1987 under Section 143(3) of the Act for assessment year 1986-87 and under Section 143(1) of the Act for assessment year 1987-88 on a total income of Rs.2,58,195/- respectively.

9 Vide order dated 14/3/1989 made under section 263 of the Act, both the assessments were set

aside by Commissioner of Income Tax, Surat with a direction to carry out fresh assessments after taking into consideration the applicability of section 43B of the Act with regard to the outstanding liabilities of excise duty appearing in the balance sheet of the assessee under the head Sundry Creditors.

10. The Assessing Officer, accordingly framed the fresh assessments making additions of Rs.58,75,999/- and Rs.44,98,378/- for assessment years 1986-87 and 1987-88 respectively, by invoking provisions of section 43B of the Act. The Assessing Officer considered the excise duty collection as part of trading receipt, but did not allow any deduction for excise duty on the ground that it was not paid to the Government account in terms of section 43B of the Act. According to the Assessing Officer, deduction was permitted only on the basis of actual payment.

11 The assessee succeeded in appeals before the Commissioner of Income Tax (Appeals) who held that excise duty cannot be considered to be a trading receipt in the assessee's hand as the assessee was merely acting as an agent of the merchant manufacturers for the purpose of collection and payment of excise duty to the Excise Department and deleted the impugned addition.

12 The revenue carried the matter in Appeal before the Income Tax Appellate Tribunal. There was difference of opinion between the members of the Bench of the Tribunal which had heard the Appeals,and the point of difference was referred to the Third Member. Ultimately, the appeals of the revenue were allowed and it was held that the assessee was not entitled to claim deduction of excise duty liabilities of Rs.58,75,999/- for Assessment Year 1986-87 and Rs.44,58,378/- for Assessment Year 1987-88 in

view of the provisions of Section 43B of the Act. It is the aforesaid order of the Tribunal which is the subject matter of challenge in these Appeals.

13 Learned Advocate Mr.Divetia submitted on behalf of the appellants that the payment made in the form of Bank Guarantee can be equated with actual payment so as to fall within the purview of Section 43B of the Act. It was submitted that the Tribunal had erred in holding that such payment is required to be disallowed under section 43B of the Act. It was urged that the expression '*actually paid*' contained in section 43B of the Act was required to be construed in such a manner, so as not to cause any hardship to the assessee and so as to serve the object of the enactment. It was submitted that the expression '*actually paid*' was required to be construed in a reasonable manner and that the furnishing of the bank guarantee which

divested the assessee of the funds, should be treated as '*actual payment*'. It was contended that once the assessee divested himself of the funds, the same would amount to sufficient compliance with the requirements of Section 43B of the Act.

14 It was submitted that the Tribunal had erred in not appreciating the fact that bank guarantee had been furnished in terms of the directions of the Supreme Court and that, therefore, the same was required to be treated as '*actual payment*' falling within the purview of Section 43B of the Act. That, by placing fixed deposits equivalent to the bank guarantee with the Bank, the assessee had not utilized or enjoyed the sum so deposited. It was urged that in view of the order of the Supreme Court, it was not possible for the assessee to make payment of the amount towards excise duty and that by providing bank guarantee, there was substantial compliance with

the provisions of Section 43B of the Act. That, '*actually paid*' does not have to be construed literally. That the same means readily available and that by virtue of the bank guarantee the funds were readily available with the department. It was submitted that the interpretation put by the Tribunal resulted in undue hardship to the assessee as the assessee has placed a large amount with the bank towards bank guarantee and was deprived of the use of the same and at the same time was held liable to pay tax on the same. It was submitted that reliance placed by the Tribunal on various decisions of the Supreme Court while interpreting the term '*actually paid*' was misplaced, as the said decisions were rendered in a different context and could not be made applicable to the facts of the present case. In conclusion, it was submitted that the Tribunal has erred in holding that the Assessing Officer was justified in invoking the provisions of Section 43B of the Act and in making addition in

respect of the excise duty collected by the assessee.

15 Mr.B.B.Naik, learned Standing Counsel for the respondent-revenue supported the order of the Tribunal. It was submitted that the excise duty collected by the assessee is a trading receipt and deduction of the same is permissible only when the same is actually paid within the meaning of section 43B of the Act. It was submitted that furnishing of bank guarantee does not amount to making actual payment within the meaning of Section 43B of the Act. That the object behind inserting Section 43B was to curb the practice adopted by the tax payers of not discharging the statutory liability in respect of excise duty etc., by disputing the same on one hand, but nonetheless claiming the liability as a deduction for the purposes of income tax assessment on the other, thus depriving the Government of its dues while enjoying benefit of non-payment. That, the

expression '*actually paid*' appearing in Section 43B of the Act is unambiguous and has to be construed strictly in consonance with the avowed aim of enacting the said provision and to further, and not to defeat, the same.

16 There is no dispute regarding the fact that the amounts collected by way of excise duty by the Appellants are trading receipts in the hands of the appellants and liable to be taxed under the Act. The short controversy involved is as to whether furnishing of Bank Guarantee in pursuance of the directions of the Supreme Court, of entire amount of disputed Excise Duty/Additional Excise Duty actually collected by the assessee, after depositing equivalent amount in fixed deposits with the bank amounts to '*actual payment*' of such duty so as to qualify for grant of deduction under section 43B of the Act.

17 As can be seen from the impugned order of the Tribunal, the Tribunal was of the opinion that furnishing of Bank Guarantee is only a security or a guarantee given by the bank to pay the disputed amount of Excise Duty collected by the assessee, in the event of the excise department succeeding in the pending litigation, and that furnishing of bank guarantee for payment of entire disputed amount of Excise Duty/Additional Excise Duty collected by the assessee in the relevant years cannot be considered equivalent to actual payment of duty in the relevant years. The Tribunal noted that it is an admitted fact that the interest income earned on the fixed deposits belonged to the assessee and that therefore, giving the bank guarantee on the basis of fixed deposits made with the bank cannot be regarded as actual payment of excise duty in the relevant years under consideration because the assessee continues to own the said fixed deposits. That, the Excise Department is

entitled to encash the bank guarantee only in the event of their succeeding in the pending litigation before the Supreme Court. That, unless such contingency viz. success of revenue in pending litigation takes place, the assessee continues to be the owner of the fixed deposits and the interest income earned thereon. In fact, the interest so earned has been returned by the appellants as taxable income in respective years. The Tribunal was of the view that the actual payment of duty will take place only when the amount of such duty reaches the coffers of the Government and is available for public purposes.

18 The Tribunal referred to the decision of the Apex Court in the case of *Allied Motors P.Ltd. Vs. Commissioner of Income Tax,(1997) 224 ITR 677* as well as the decision of this Court in the case of *Lakhanpal National Ltd. Vs. Income Tax Officer,(1986) 162 ITR 240* in relation to the

proposition that under Section 43B of the Act deduction in respect of tax or duty under any law would be allowed in computing the income only in that previous year in which such sum is actually paid by the assessee. The Tribunal observed as follows :

> *" xxx xxx In the present case the assessee had the choice of making the payment of Excise Duty/Additional Excise Duty collected by him from various customers to the Excise Department in the respective years and still contest their liability to collect and pay such amounts before the Hon'ble Courts. In that event the assessee could claim deduction in respect of such amount on the basis of actual payment made in the relevant years of collection. The option was still available with the assessee to deposit the entire amount with the Excise Department instead of depositing the full amount in fixed deposits with the bank and ask the bankers to give bank guarantee on the strength of such fixed deposits. In case the Excise Department fails in the pending litigation, the assessee could claim refund of such Excise duty payments alongwith interest under the provisions of Excise Laws. Instead of making actual payment of amount of Excise Duty/Additional Excise Duty collected by the assessee to the Excise Department, it opted to approach the Hon'ble Court for granting of stay, which the Hon'ble Court granted on the condition that the assessee should furnish bank guarantee. The Hon'ble Court did not direct that the assessee should deposit 100% amount in fixed deposits with the banks. It was a matter depending on the terms and conditions which were agreed upon by the assessee with the bankers for providing bank guarantee in favour of the Excise Department. Furnishing of bank guarantee to secure the payment of dues to Excise Department*

> *in the event of their succeeding in pending litigation cannot therefore be regarded as actual payment of tax or duty in terms of section 43B of the Act".*

19 Reliance was placed upon decisions of the Apex Court in the case of *Oswal Agro Mills Ltd. Vs. Assistant Collector of Central Excise (1994) 2 SCC 546* as well as in the case of *Somaiya Organics (India) Ltd. Vs. State of UP and Another (2001) 5 SCC 519* for the proposition that the amount of disputed tax or duty secured by a Bank Guarantee cannot be said to amount to actual payment to the revenue.

20 Section 43B which relates to certain deductions to be only on actual payment, has, originally been inserted by The Finance Act,1983. Section 43B as is relevant for the purpose of the present appeals, as it stood at the relevant time, reads as under :

> *"43B. Notwithstanding anything contained in any other provision of this Act, a deduction otherwise allowable under this Act in respect of-*

(a) any sum payable by the assessee by way of tax or duty under any law for the time being in force, or
(b) any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees,
shall be allowed (irrespective of the previous year in which the liability to pay such sum was incurred by the assessee according to the method of accounting regularly employed by him) only in computing the income referred to in section 28 of that previous year in which such sum is actually paid by him."

21 The scope of effect of the relevant part of the originally inserted section 43B has been elaborated in the following portion of the departmental circular No.372 dated 8/12/1983 as follows :

"35.1 Under section 145 of the Income-tax Act, profits and gains of business or profession are computed in accordance with the method of accounting regularly employed by the assessee. Broadly stated, under the mercantile system of accounting, income and expenditure are accounted for on the basis of accrual and not on the basis of actual receipts or disbursements. For the purposes of computation of profits and gains of business or profession, section 43(2) of the Income-tax Act defines the word 'paid' to mean 'actually paid or incurred' according to the method of accounting on the basis of which the profits or gains are computed.

35.2 Several cases have come to notice where taxpayers do not discharge their statutory

liability such as in respect of excise duty, employer's contribution to provident fund, Employees' State Insurance Scheme, etc., for long periods of time, extending sometimes to several years. For the purpose of their income-tax assessments, they claim the liability as deduction on the ground that they maintain accounts on mercantile or accrual basis. On the other hand, they dispute the liability and do not discharge the same. For some reason or the other, undisputed liabilities also are not paid.

35.3 To curb this practice, the Finance Act has inserted a new section 43B to provide that deduction for any sum payable by the assessee by way of tax or duty under any law for the time being in force or any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees shall irrespective of the previous year in which the liability to pay such sum was incurred, be allowed only in computing the income of that previous year in which such sum is actually paid by the assessee".

22. Section 43B of the Act opens with a non-obstante clause. The same, therefore, has an overriding effect over the other provisions of the Act. In view of the non-obstante clause contained in Section 43B, the deduction which is otherwise allowable under the Act in respect of sums payable by the assessee by way of tax or duty under any law for the time being in force, can be allowed in computing the income

referred in Section 28 of the Act only in that previous year in which such sum is actually paid, regardless of the previous year in which the liability to pay such sum was incurred by the assessee according to the method of accounting regularly employed by him.

23. The expression employed in the section is '*actually paid*'. In view of the non-obstante clause contained in the section, it is not permissible to refer to the expression '*paid*' as defined under section 43(2) of the Act or under any other provision of the Act. Hence, the plain meaning of the words '*actually paid*' is required to be taken into consideration. The word 'actual' has been defined as something real in opposition to constructive or speculative. '*Actually*' means really, truly in fact. Therefore, the plain meaning of the expression '*actually paid*' means that the sum should have been actually paid to the coffers of

the revenue i.e. really paid, and not constructively. Importing any other meaning, as is sought to be canvassed by the learned Advocate for the appellant, would amount to doing violence to the plain meaning of the statute. When words of the statute are clear and unambiguous there is no need to adopt any other meaning or provision of the Act.

24 A Bank guarantee is in the nature of a security or a guarantee, which imposes an obligation on the Bank to make payment in terms of the Bank guarantee, upon the happening of a contingency on the occurrence of which the guarantee becomes enforceable. In the facts of the present case, by furnishing bank guarantees pursuant to the order of the Supreme Court, the appellants had merely created a right in favour of the Excise Department to enforce the payment of excise duty in the event of their succeeding in the pending litigation. The same is not

equivalent to actual payment of tax or duty by way of which funds would be available for meeting the Government expenditure etc. The Supreme Court in the case of Assistant Collector, Central Excise V. Dunlop India Ltd. (1985) 154 ITR 172, has held that Governments are not run on mere bank guarantees. That, no governmental business or for that matter no business of any kind can be run on mere bank guarantees, and that liquid cash is necessary for running of a Government, as indeed any other enterprise. Thus, it is only when pursuant to payment by whatsoever mode adopted by the assessee, liquid cash is available to the Government for the purpose of governmental business, that it can be said that the sum due has actually been paid to the Government. In the circumstances by furnishing bank guarantee towards excise duty liability, it cannot be said that the assessee had “actually paid” the excise duty in terms of section 43B of the Act. In fact,

furnishing of bank guarantee towards excise duty liability does not amount to even constructive payment of the said duty. The ownership of the funds placed as fixed deposits for obtaining bank guarantee was of the appellants and remained so till the point of time of encashment of the bank guarantees. Payment presupposes transfer of rights of ownership from the payer to the payee.

25 The Apex Court in the case of *Oswal Agro Mills Ltd. And Another Vs. Assistant Collector of Central Excise, (1994) 2 SCC 546* was called upon to decide as to whether it can be said that furnishing of a bank guarantee for all or part of the disputed excise duty pursuant to an order of the Court is equivalent to payment of the amount of excise duty. The Supreme Court answered the question in the negative and held as follows :

> *"For the purposes of securing the revenue in the event of the revenue succeeding in proceedings before a court, the court, as a condition of staying the demand for the disputed tax or duty, imposes a condition that the assessee shall provide a bank guarantee for the full amount of such tax or duty or part thereof. The bank guarantee is required to be given either in favour of the principal administrative officer of the court or in favour of the revenue authority concerned. In the event that the revenue fails in the proceedings before the court the question of payment of the tax or duty, the amount of which is covered by the bank guarantee, does not arise and, ordinarily, the court, at the conclusion of its order, directs that the bank guarantee shall stand discharged. Where the revenue succeeds the amount of the tax or duty becomes payable by the assessee to the revenue and it is open to the revenue to invoke the bank guarantee and demand payment thereon. The bank guarantee is security for the revenue, that in the event the revenue succeeds its dues will be recoverable, being backed by the guarantee of a bank. In the event, however unlikely, of the bank refusing to honour its guarantee it would be necessary for the revenue or, where the bank guarantee is in favour of the principal administrative officer of the court, that officer to file a suit against the bank for the amount due upon the bank guarantee. The amount of the disputed tax or duty that is secured by a bank guarantee cannot, therefore, be held to be paid to the revenue".*

26 The aforesaid view was confirmed by a Constitution Bench of the Apex Court in the case of *Somaiya Organics (India) Ltd. and Another Vs. State of U.P. and Another (2001) 5 SCC 519,* wherein it was held that :*"Furnishing of bank*

guarantee is only a promise by the bank to pay to the beneficiary the amount under certain circumstances contained in the bank guarantee. Furnishing of bank guarantee cannot tantamount to making of payment as it was to avoid making payment of the vend fee that bank guarantees were issued".

27 In the facts of the present case, it can be said that the bank guarantee had been furnished by the appellants towards excise duty liabilities, though pursuant to directions of the Supreme Court, primarily to avoid making payment of excise duty to the Department. Hence, in view of the principles enunciated by the Apex Court in the aforesaid decision, it cannot be said that the furnishing of bank guarantee towards payment of excise duty liabilities amounts to actual payment as envisaged by the provisions of Section 43B of the Act.

28 In the circumstances, there cannot be said to be any infirmity in the view taken by the Tribunal. The question is answered accordingly. The Appeals are, accordingly, dismissed with no order as to costs.

TAX APPEAL No. 8 OF 2004.

1 This Appeal was admitted on 20/09/2004 and the following substantial questions of law had been framed :

> *"(I) Whether on the facts and in the circumstances of the case, the Appellate Tribunal was justified in law in confirming the disallowance of excise duty liability of Rs.33,39,225/- under Section 43B of the Income Tax Act,1961 in spite of the appellant having placed full amount of excise duty liability with Bank of Baroda in Fixed Deposit pursuant to the order and direction of the Hon'ble Supreme Court and thus parted with funds equivalent to Excise Duty liability ?*
>
> *(II) Whether on the facts and in the circumstances of the case, the Appellate*

Tribunal was justified in law in holding that furnishing of bank guarantee against excise duty liability pursuant to the order and direction of the Hon'ble Supreme Court did not tantamount "actual payment" within the meaning of Section 43B of the Act?"

2 It is an admitted position that the issue involved in the present Appeal is identical to the issue involved in Tax Appeal Nos.193 & 194 of 2003 which has been decided by an order of even date.

3 For the reasons stated in order of even date in Tax Appeals No.193 & 194 of 2003 the question stands answered accordingly. The Appeal is, accordingly, dismissed with no order as to costs.

Sd/- Sd/-
(D.A.MEHTA,J) (H.N.DEVANI,J)

m.m.bhatt